

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LORRAINE K. MURPHY	:	DETERMINATION
D/B/A MURPHY'S LAKE LIQUORS & WINE	:	DTA NO. 809598
	:	
for Revision of Determinations or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period June 1, 1983	:	
through May 31, 1988.	:	

Petitioner Lorraine K. Murphy d/b/a Murphy's Lake Liquors & Wine, c/o Lawrence J. Groskin, Esq., Continental Road, Tuxedo Park, New York 10987 filed a petition for revision of determinations or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1983 through May 31, 1988.

A hearing was held before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 500 Federal Street, Troy, New York, on March 11, 1992 at 1:15 P.M., with all briefs to be submitted by August 26, 1992. Petitioners appeared by Lawrence J. Groskin, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Kevin A. Cahill, Esq., of counsel).

ISSUES

I. Whether the assessments at issue were timely issued, i.e., whether valid consents extending the period of limitation for assessment were executed by petitioner.

II. Whether the Division of Taxation properly determined additional sales and use taxes due from petitioner for the period at issue.

III. Whether, pursuant to the provisions of Tax Law §§ 1131(1) and 1133(a), petitioner was personally responsible for the collection of sales and use taxes due from Murphy's Lake Liquors & Wine for the period at issue.

IV. Whether petitioner has substantiated that the failure to accurately report and pay over

sales and use taxes on behalf of Murphy's Lake Liquors & Wine was due to reasonable cause and not due to willful neglect, thereby warranting abatement of penalties imposed.

FINDINGS OF FACT

Pursuant to an audit of Lorraine K. Murphy d/b/a Murphy's Lake Liquors & Wine ("petitioner") which commenced in March 1986, the Division of Taxation ("Division"), on August 5, 1988, issued two notices of determination and demands for payment of sales and use taxes due as follows:

<u>Period</u>	<u>Tax</u>	<u>Penalty</u>	<u>Interest</u>	<u>Total</u>		
6/1/83 - 11/30/86		\$10,726.03	\$2,829.25	\$5,768.06		\$19,323.34
12/1/86 - 5/31/88		2,932.93	547.43	285.96		3,766.32

Prior to the issuance of the aforesaid notices of determination, the parties executed the following consents extending the period of limitation for assessment of sales and use taxes:

<u>Date Executed</u>	<u>Periods Extended</u>	<u>Date for Assessment</u>
8/28/86	6/1/83 - 11/30/83	3/20/87
3/11/87	6/1/83 - 5/31/84	9/20/87
7/28/87	6/1/83 - 11/30/84	3/20/88
2/29/88	6/1/83 - 8/31/85	12/20/88

While each of the consents contains an original signature of a representative of the Division, the first consent (dated August 28, 1986) and last consent (dated February 29, 1988) appear to be photocopies, i.e., they contain photocopied signatures of petitioner. The second consent (dated March 11, 1987) and the third consent (dated July 28, 1987) contain what appear to be the originals of the signatures of both Lorraine K. Murphy and the representative of the Division.

At the hearing, petitioner's representative raised an issue concerning the validity of petitioner's signatures on the first and last consents since they were photocopies rather than originals of the consents allegedly executed by petitioner. Petitioner did not appear at the hearing to testify as to the signatures in question nor was any evidence presented by petitioner which would indicate that the signatures were forgeries or that petitioner did not sign the consents in question. The Division's representative indicated at the hearing that the originals were not in the Division's file, but that he would attempt to locate the originals of the consents

and submit them into evidence after the hearing. The originals were not provided.

The original auditor in this matter was Caroline Carter who was assigned the case on March 21, 1986. In November 1987, due to the fact that Ms. Carter left the employment of the Division, the case was assigned to Bruce Dawson. The field audit record of Caroline Carter states that a waiver was mailed on August 26, 1986. With respect to the other waiver in question (February 29, 1988), the field audit record of Bruce Dawson contains no entry on or about that date. By virtue of the absence of an entry in the field audit record, Mr. Dawson testified that he must have obtained the waiver by mail.

Ms. Carter mailed an appointment letter to petitioner on March 21, 1986 which requested that all books and records pertaining to her sales tax liability for the audit period (the audit period was listed as 3/1/83 to present). The letter specifically requested journals, ledgers, sales and purchase invoices, register tapes, exemption certificates, as well as Federal returns and bank statements.

At the scheduled appointment (at the place of business), the auditor received no records relating to sales except for a daily listing prepared by petitioner. There were no register tapes or sales invoices provided. The only records provided were Federal income tax returns for 1983 and 1984, purchase invoices for September and October 1985, cancelled checks, monthly bank statements and a day book. The auditor listed the monthly deposits per the vendor's bank statements and per the list of daily sales for the audit period. Purchases per checks were listed for the quarter September 1 through November 30, 1985.

Ms. Carter decided to perform a markup test utilizing purchase invoices for the months of September and October 1985. Cost of purchases for September 1985 was determined to be \$19,950.67 and for October 1985 cost of purchases was \$21,895.06 (total for the two months = \$41,845.73).

To determine the liquor markup, the auditor applied a straight 12% markup (the auditor's report indicated that this percentage was obtained from petitioner). Due to the fact that Ms. Carter left the employ of the Division during 1987, it is unclear where the selling prices

(and resulting markup percentage) of wine were derived from. As previously indicated, the auditor's workpapers stated that liquor was marked up 12%. The workpapers also indicated that the markup on wine fluctuated. It is, therefore, unclear whether the selling prices for wine were obtained from petitioner (vendor's price book), from an examination of shelf prices or from some other source.

The selling price for the September 1985 purchases was determined to be \$24,317.72 and \$25,842.48 for the October 1985 purchases (total for the two months = \$50,160.20). The gross profit was found to be \$8,314.47 for these two months (\$50,160.20 selling price - \$41,845.73 cost of purchases). The resulting markup percentage was calculated to be 19.87% (\$8,314.47 gross profit divided by \$41,845.73 total cost). This markup percentage was computed by Bruce Dawson who, after the departure of Caroline Carter, was assigned to the case on November 4, 1987.

When Mr. Dawson was assigned to the case, he contacted petitioner's accountant (Irving Kapp, C.P.A.) to request additional books and records. He was informed by the accountant that the Internal Revenue Service had seized all of the records. In June 1988, he contacted petitioner in order to update the audit. He was told that the records had been released and he made an appointment to review the records. On July 29, 1988, the auditor spoke with petitioner's attorney (Lawrence M. Groskin) who stated that he would not provide any additional books and records due to the fact that petitioner was under criminal investigation. The auditor, therefore, prepared the assessment based upon the records made available to (and the schedules prepared by) the original auditor.

The assessment was arrived at by determining purchases for the same sales tax quarter as was utilized in computing the markup percentage. Since the original auditor had purchase invoices only for the months of September and October 1985, but had checks and bank statements for those months plus the remaining month (November 1985) in that quarter, purchases per checks were used by Mr. Dawson. Total purchases per the vendor's checks were \$53,539.13 (\$20,846.24 for September, \$23,010.62 for October, and \$9,682.27 for November)

for the sales tax quarter September 1 through November 30, 1985. The total purchases were multiplied by the markup percentage (see, Finding of Fact "3") of 19.87%. The result (\$10,638.23) was added to total purchases per vendor's checks (\$53,539.13) to equal gross sales of \$64,177.36. Petitioner had reported gross sales of \$55,911.00 for the period. Unreported gross sales were, therefore, found to be \$8,266.36 (\$64,177.36 - \$55,911.00). Unreported gross sales were then divided by reported gross sales to arrive at an unreported taxable percentage of 14.78% (\$8,266.36 divided by \$55,911.00).

The unreported taxable percentage (14.78%) was multiplied by gross sales reported for the audit period to arrive at additional gross sales (\$164,422.00). The additional gross sales were then added to gross sales reported which resulted in total taxable sales of \$1,276,868.00 for the audit period. Total tax due was determined to be \$78,289.60. Sales tax paid for the period was \$64,630.64. Additional tax due was, therefore, \$13,658.96 which was the total amount of tax assessed on the two notices of determination issued to petitioner.

Subsequent to the issuance of the assessments, petitioner filed an amended sales tax return for the quarter ended November 30, 1988. Since petitioner's representative claimed that the return was for the preceding three quarters as well, the auditor (Mr. Dawson) made an adjustment for the last two quarters of the audit period (December 1, 1987 through May 31, 1988) resulting in a decrease of \$342.24 for the quarter ended February 29, 1988 and of \$241.15 for the quarter ended May 31, 1988. The total adjustment (\$583.39) thereby reduced total additional tax due to \$13,075.57, plus penalty and interest.

The auditor (Mr. Dawson) testified that he had performed approximately 12 to 15 audits of liquor stores during his 18-year employment as a sales tax auditor. He stated that the retail liquor business is a seasonal business with the largest sales from mid-November through the end of December. After that, sales drop off and then increase somewhat in the summer. The auditor testified that the sales from the three months of September, October and November would be a fair representative sample of the annual sales.

After the auditor computed the assessment, he met with petitioners' representative (Mr.

Groskin) and provided him with copies of all audit worksheets. When Mr. Groskin disagreed with the assessment, the auditor stated that he would be willing to perform a purchase markup audit for another test period if so desired, but that Mr. Groskin indicated that no additional records would be forthcoming.

Despite petitioner's assertions that a substantial amount of shoplifting occurred in her store and that she made nontaxable sales, no substantiation of either was provided to the auditor. The auditor visited the premises, which he described as a small store located in the middle of Greenwood Lake, New York. The audit report indicated that the vendor was a sole proprietor. His recollection of the premises was that the cash register was located near the entrance and that the person operating the register had a clear view of all of the shelves on which the inventory was displayed. No resale certificates or exemption certificates of any kind were provided during the audit. Therefore, no allowances for nontaxable sales or for losses due to shoplifting were given.

The auditor testified that Federal returns were provided by petitioner only for the years 1983 and 1984. Had he been provided with returns through 1987 (as requested), he stated that he could have adjusted the markup to allow for variations in inventory. For 1984, the Federal return revealed a negative ending inventory, the explanation for which was not provided to the auditor.

The auditor admitted at the hearing that purchase invoices were more reliable, in his opinion, than cancelled checks because the invoices indicate purchases for a particular month while checks could reflect payments for liquor orders which were delivered in prior months. Purchase invoices were available, however, only for the months of September and October 1985.

SUMMARY OF PETITIONER'S POSITION

(a) For the period June 1, 1983 through May 31, 1985, the assessments were time barred (Tax Law § 1147[b]) because two of the consents extending the period of limitation for assessment of sales and use taxes were photocopies and, as such, violate the best evidence rule.

Petitioner contends that the originals of such consents are the primary evidence and must, therefore, be produced unless a basis is laid for the copies by showing that the originals cannot be produced. The Division's assertion that the originals were not in the file is not sufficient.

(b) The assessments should have included allowances for theft and breakage and the failure to do so causes the audit to lack a rational basis. Petitioner cites Matter of Shoprite Wines and Liquors (Tax Appeals Tribunal, February 22, 1991) as authority for the granting of such allowances. Petitioner submitted a magazine article (Exhibit No. "3") which she contends substantiates the basis for a 7% allowance for shoplifting.

(c) The computation of unreported sales is erroneous because the invoices utilized to compute cost of purchases for September and October 1985 are inconsistent with the checks actually paying such costs. Since the amounts of the invoices are less than the total of checks paid, a higher markup percentage was determined thereby resulting in a higher calculation of gross sales. The Division used the lower amounts for cost of purchases to compute the markup when it was to its advantage (higher markup), then used the higher amounts for cost of purchases to compute gross sales when, again, it was to its advantage (higher gross sales). The same cost amounts should have been used to compute markup and gross sales. In addition, utilization of checks paid is improper because the checks could well be payment for purchases occurring in prior months and, if for purchases made in August, for purchases outside of the test quarter (September 1 through November 30, 1985).

CONCLUSIONS OF LAW

A. Tax Law § 1147(c) provides, in part, as follows:

"Where, before the expiration of the period prescribed herein for the assessment of an additional tax, a taxpayer has consented in writing that such period be extended the amount of such additional tax due may be determined at any time within such extended period. The period so extended may be further extended by subsequent consents in writing made before the expiration of the extended period."

B. State Administrative Procedure Act § 306(1) provides, in part, as follows:

"Unless otherwise provided by statute, agencies need not observe the rules of evidence observed by courts, but shall give effect to the rules of privilege recognized by law."

State Administrative Procedure Act § 306(2) provides, in part, as follows:

"All evidence, including records and documents in the possession of the agency of which it desires to avail itself, shall be offered and made a part of the record, and all such documentary evidence may be received in the form of copies or excerpts, or by incorporation by reference" (emphasis added).

The procedural rules of the Tax Appeals Tribunal provide that:

"Technical rules of evidence will be disregarded to the extent permitted by the decisions of the courts of this State, provided the evidence offered appears to be relevant and material to the issues" (20 NYCRR 3000.10[d][1]).

C. As indicated in Finding of Fact "2", the validity of the consents was raised, for the first time, at the hearing when petitioner's representative became aware that two of the four consents which were about to be offered into evidence by the Division were photocopies rather than originals. Petitioner was not present at the hearing nor was any other evidence introduced which would indicate that either of the consents were forgeries or that the dates thereon had been altered.

In Matter of The Tides Inn (Tax Appeals Tribunal, April 2, 1992), the Tribunal set forth the requirements for raising the defense of the statute of limitations as to a bar to an assessment, stating:

"It is well established that the statute of limitations defense is waived unless affirmatively raised by the taxpayer [citations omitted]. To establish this defense, the party raising it must go forward with a prima facie case showing the date on which the limitations period commences, the expiration of the statutory period and receipt of mailing of the notice after the running of the period (see, Amesbury Apts., Ltd. v. Commissioner, 95 TC 227; Robinson v. Commissioner, 57 TC 735). Where the party raising the defense has satisfied this initial burden, the burden of going forward with the evidence shifts to the Division to demonstrate that the bar of the statute is not applicable (see, Amesbury Apts., Ltd. v. Commissioner, *supra*; Adler v. Commissioner, 85 TC 535). The Division must then proceed with countervailing evidence that the statutory notice was timely mailed (see, Coleman v. Commissioner, 94 TC 82.)"

While the issue in the present matter relates to the validity of the consents extending the period of limitation for assessment, it is, nevertheless, a raising of the same defense, i.e., that the assessment was time barred due to the invalidity of the consents. From an examination of the evidence presented by petitioner, it would appear that she failed to sustain her burden of going forward with a prima facie case. Other than noting that the Division intended to offer

copies of two of the four consents purportedly executed by petitioner, petitioner's representative merely raised an issue concerning the possibility that the two consents had not been signed by petitioner or that, in the alternative, the dates thereon may have been altered. At no time did petitioner, either through testimony, affidavit or any other form of evidence, state affirmatively that she did not sign the consents or that the dates had, in fact, been altered. However, even assuming, arguendo, that she did go forward with a prima facie case, the Division may sustain its burden of going forward with the evidence to demonstrate that the assessment was not barred by the statute of limitations, i.e., that the consents were validly executed, by means of secondary evidence.

Clearly, it is permissible to receive copies into evidence at an administrative hearing (see, Conclusion of Law "B"). From the failure of the Division's representative to produce the originals of the two waivers in question it can reasonably be inferred that they were lost. As noted in Finding of Fact "2", these photocopies do contain what appear to be original signatures of representatives of the Division. The Tax Court and other Federal courts have permitted the introduction of secondary evidence to sustain the Internal Revenue Service's burden of proving that a duly executed waiver extending a statute of limitations had been executed by the taxpayer (see, Bridges v. Commr., 38 TCM 1126; U.S. v. Conry, 77-2 US Tax Cas ¶ 9759, affd 631 F2d 599, 81-2 US Tax Cas ¶ 9618; Marquis v. U.S., 348 F Supp 987, 72-2 US Tax Cas ¶ 9700).

As noted in Finding of Fact "3", the field audit record of the initial auditor, Caroline Carter, indicated that a waiver was mailed on August 26, 1986, two days prior to the date on the photocopy. While the subsequent auditor, Bruce Dawson, could not clearly recall how the last waiver was obtained, his testimony was that since there was no entry in his field audit record for a date on or about February 29, 1988, he could reasonably assume that the consent was obtained by mail rather than by means of a personal visit to petitioner. It should also be noted that the signature of petitioner on all of the waivers, both the ones containing original signatures and those which are copies, appear to be very similar.

Therefore, it must be concluded that, absent evidence to the contrary, the Division has

sustained its burden of proving that consents were validly executed by petitioner and, as such, the assessments at issue were not barred by the three-year statute of limitations set forth by Tax Law § 1147(b).

D. Tax Law § 1138(a)(1) provides, in part, that if a return required to be filed is incorrect or insufficient, the amount of tax due shall be determined on the basis of such information as may be available. This section further provides that, if necessary, the tax may be estimated on the basis of external indices. The resort to external indices is predicated upon a finding of insufficiency in the taxpayer's recordkeeping such that verification of sales is a virtual impossibility (Matter of Chartair, Inc. v. State Tax Commn., 65 AD2d 44, 411 NYS2d 41). In such circumstances, the Division must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commn., 119 AD2d 948, 501 NYS2d 219), and the burden is on petitioner to establish by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commn., 127 AD2d 943, 512 NYS2d 542).

To determine the adequacy of a taxpayer's records, the Division must first request and thoroughly examine the taxpayer's books and records for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, 521 NYS2d 826, lv denied 71 NY2d 806, 530 NYS2d 109; Matter of King Crab Restaurant v. State Tax Commn., 134 AD2d 51, 522 NYS2d 978). The purpose of this examination is to determine whether the records are so insufficient as to make it virtually impossible for the Division to verify taxable sales receipts and conduct a complete audit (Matter of Chartair, Inc. v. State Tax Commn., supra; Matter of Ronnie's Suburban Inn, Tax Appeals Tribunal, May 11, 1989).

E. The original auditor mailed an appointment letter to petitioner (see, Finding of Fact "3") in which books and records were requested. Subsequently, auditor Bruce Dawson requested additional books and records up through the end of the period in issue (see, Finding of Fact "4"). Since petitioner failed to provide records upon which sales for the audit period could be verified, the Division was clearly authorized to resort to external indices which, in this case,

was a purchase markup audit.

Petitioner does not contend that the audit method utilized was improper, but alleges that the resulting assessments were erroneous because the Division failed to include allowances for theft and breakage and, in addition, that the Division utilized different amounts as costs (it used costs per invoices to determine the markup percentage and costs per checks to compute gross sales) which led to inflated assessments.

F. In support of her contention that allowances for theft and breakage should have been granted, petitioner cites Matter of Shoprite Wines and Liquors (supra) as the authority for the granting of such allowances. In that case, the Tribunal was unable to determine, from the record, the source of the auditor's 2% allowance for theft and breakage. In support of their claim that a 2% allowance was too low, the petitioners submitted an article from an industry magazine (Beverage Media) which stated that the average nationwide loss in package stores to theft alone was 7% of inventory. It must be noted, however, that testimony was also provided. Based upon the testimony and the article, the Tribunal concluded that, weighing the evidence submitted by petitioners versus the lack of any evidence to support the Division's 2% allowance, the petitioners sustained their burden of proving that the auditor should have utilized a 7% allowance.

In the present matter, there was no evidence whatsoever to justify any allowance for theft and/or breakage. No one appeared on behalf of petitioner to testify at the hearing. No documentary evidence was produced to substantiate petitioner's claim that such allowances should have been granted. While petitioner herein also introduced (Petitioner's Exhibit No. "3") the same magazine article from Beverage Media, this standing alone without some evidence as to what actually occurred at Murphy's Lake Liquors & Wine does not justify an allowance for theft and/or breakage. It is petitioner's burden to substantiate the exemptions it claims from taxation (Tax Law § 1132[c]; see, Matter of McCluskey's Steak House v. State Tax Commn., 80 AD2d 713, 437 NYS2d 736; Matter of Koren-DiResta Construction Co. v. State Tax Commn., 138 AD2d 909, 526 NYS2d 654). Petitioner herein has failed to substantiate her entitlement to

allowances for theft and/or breakage.

G. Petitioner's other objection to the assessments resulting from the purchase markup audit concerns the auditor's utilization of purchase invoices for September and October 1985 to compute the markup percentage and his use of checks paid for the months of September through November 1985 to arrive at an unreported taxable percentage which was then applied to determine additional gross sales (see, Findings of Fact "3" and "5").

The original auditor (Caroline Carter), in performing her purchase markup audit, was furnished invoices only for the months of September and October 1985.¹ Petitioner contends that the auditor used the invoice amounts (which were lower than the amount of checks paid for the same months) to compute the markup which resulted in a higher markup percentage, then used the checks paid to determine additional gross sales which resulted in greater additional gross sales than would have been computed if the invoice amounts had been utilized. Petitioner, therefore, seeks an adjustment based on such an inconsistency.

The markup percentage was computed by Mr. Dawson using the information (cost of purchases and selling prices) obtained by Ms. Carter. Petitioner correctly points out, in her brief, that checks paid may not be an accurate representation of purchases for a particular month since the checks could well be issued to pay for purchases from prior months. However, in order to accurately calculate a markup percentage, it is imperative to use, if possible, the actual purchase invoices for the particular months because such invoices are needed to determine the brands purchased and the selling prices thereof. This is exactly what these auditors did. Accordingly, it must be found that, based upon the books and records presented, the markup percentage was properly determined.

With respect to the calculation of additional gross sales, the auditor used a test quarter,

¹Due to the unavailability of Ms. Carter to testify at the hearing (she was no longer employed by the Division), it is unclear whether invoices for November 1985 were available, although it must be pointed out that petitioner never furnished invoices for November 1985 to the subsequent auditor, Mr. Dawson, nor were such invoices provided to the Administrative Law Judge at the hearing.

i.e., September 1 through November 30, 1985. There is no indication that the auditors were furnished with purchase invoices for

November 1985, other than in the form of checks paid during that month. The auditors could have taken purchases per invoices for September (\$19,950.67) and for October (\$21,895.06) 1985 and averaged the two months to determine November's purchases. Had this been done, November purchases would have been \$20,922.87 ($\$19,950.67 + \$21,895.06 = \$41,845.73$ divided by 2). Instead, purchases per checks paid for November (\$9,682.27) were used, which actually resulted in lower additional gross sales being determined. While it is true that purchases per checks were slightly higher than purchases per invoices for these months (\$20,846.24 vs. \$19,950.67 for September; \$23,010.62 vs. \$21,895.06 for October), the resulting effect on additional gross sales is still less than if the average per invoices was used for November rather than purchases per checks paid. Therefore, it cannot be found herein that either the audit method employed or the resulting assessments were unreasonable or erroneous.

H. Since Murphy's Lake Liquors & Wine was a sole proprietorship and since no evidence was produced which would indicate that anyone other than petitioner exercised any financial control over the business, it must be found that Lorraine K. Murphy was, pursuant to the provisions of Tax Law §§ 1131(1) and 1133(a), personally responsible for the collection of sales and use taxes due from the business for the period at issue.

I. Petitioner offered no evidence to show that her failure to accurately report and pay over sales and use taxes on behalf of Murphy's Lake Liquors & Wine was due to reasonable cause and not due to willful neglect. Penalties imposed must, therefore, be sustained.

J. The petition of Lorraine K. Murphy d/b/a Murphy's Lake Liquors & Wine is denied and the notices of determination and demands for payment of sales and use taxes due issued to

petitioner on August 5, 1988 are sustained, except as adjusted per Finding of Fact "6".

DATED: Troy, New York
January 21, 1993

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE